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8 UNITED STATES DISTRICT COURT  
9 CENTRAL DISTRICT OF CALIFORNIA

10  
11 ROBERT P. MOSIER as Receiver for  
PRIVATE EQUITY MANAGEMENT  
12 GROUP, INC. and PRIVATE EQUITY  
MANAGEMENT GROUP, LLC and  
13 their subsidiaries and affiliates,

14 Plaintiff,

15 v.

16 STONEFIELD JOSEPHSON, INC.,  
CPAs, a California Corporation; and  
17 DOES 1-10 inclusive,

18 Defendants.  
19

CASE NO. 2:11-cv-02666 PSG (Ex)  
[Hon. Philip S. Gutierrez]

**REQUEST FOR PUBLICATION OF  
COURT'S JULY 30, 2013  
DECISION**

Date: [No hearing required]  
Time: [No hearing required]  
Courtroom: [No hearing required]

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1 **1. PRELIMINARY STATEMENT.**

2 Pursuant to the Ninth Circuit's Local Rule 36-4, Stonefield Josephson, Inc.,  
 3 CPAs ("Stonefield") respectfully requests the publication of this Court's July 30, 2013  
 4 decision in the matter of *Robert P. Mosier v. Stonefield Josephson, Inc., CPAs*.  
 5 Stonefield requests that this Court publish its decision because it satisfies the  
 6 following two requisites for publication under Rule 36-2: (1) it clarifies a rule of law  
 7 and (2) it involves a legal or factual issue of substantial public importance.

8 **2. THE DECISION CLARIFIES THE REQUIREMENTS FOR PROOF OF**  
 9 **CAUSATION IN AUDITOR LIABILITY CASES.**

10 The Court's decision warrants publication because it clarifies the application of  
 11 *Smolen v. Deloitte, Haskins & Sells*, 921 F.2d 959 (1990), which held that in an action  
 12 for negligent rendering of audit services, "a plaintiff's reliance on a professional's  
 13 misrepresentations is an element of professional negligence of the variety alleged  
 14 here." 921 F.2d at 965. First, this Court's decision clarifies that "reasonable" or  
 15 "innocent" reliance is required to establish causation. Second, the decision also  
 16 clarifies that reliance on the audit reports of a company is unreasonable where those  
 17 reports disclose substantial violations of Generally Accepted Accounting Principles  
 18 ("GAAP") and that the audit reports did not reflect an assessment of all of the  
 19 company's assets.

20 **A. The Decisions Clarifies That "Reasonable" or "Innocent" Reliance Is**  
 21 **Required To Establish Causation In Audit Negligence Cases.**

22 The Court's decision holds that, in the context of a professional negligence  
 23 claim against an accountant for audit negligence, in order to prove causation the  
 24 plaintiff must establish reasonable reliance on the audit reports prepared by the  
 25 defendant. As the Court's decision explains, "[w]hile reasonable reliance is not a per  
 26 se element of the tort of professional negligence, reasonable reliance is an essential  
 27 means of proving causation in an action based on false representations in an auditor's  
 28 report." Dkt. # 155, at 5. While the Court's decision relies upon the holding in

1 *Smolen* and also cites *Stagen v. Stewart-West Coast Title Co.*, 149 Cal.App. 3d 114,  
 2 119-20 (1983), the decision clarifies that the rationale for the *Smolen* decision is  
 3 generally applicable to actions for professional negligence based upon an auditor's  
 4 alleged negligent preparation of an audit.

5 The Court's decision is significant in its adoption of the reasoning of the Sixth  
 6 Circuit's decision in *In re NM Holdings Co., LLC*, 622 F.3d 613, 620 (6th Cir. 2010)  
 7 and Fifth Circuit's decision in *FDIC v. Ernst & Young*, 967 F.2d 166, 170 (5th Cir.  
 8 1992). As the Court's decision explains, as in each of those cases, "reliance is not an  
 9 independent element of the tort of professional negligence and so the Receiver did not  
 10 need to plead reliance in order to proceed on his professional negligence claim past a  
 11 motion to dismiss." Dkt. #155, at 8. However, on summary judgment, "in order to  
 12 prove the essential element of causation, the Receiver must present evidence of  
 13 reliance; if nobody relied on the audits as accurate, then the audit could not have  
 14 caused PEMGroup's purported losses." *Id.*

15 **B. The Decision Also Clarifies That Reliance On Audit Reports**  
 16 **Containing Significant Disclosures And Qualifications Regarding**  
 17 **GAAP Violations Is Unreasonable.**

18 The Court's decision clarifies that *Smolen*'s requirement for establishing  
 19 causation through proof of reliance cannot be satisfied where the audit reports in  
 20 question contain disclosures of GAAP violations and expressly indicate that the  
 21 auditor could not express an opinion on a significant portion of the company's assets.  
 22 As the Court's decision states, "given the disclosure that GVEC had violated GAAS in  
 23 numerous ways and so the audit reports did not reflect an assessment of all of GVEC's  
 24 assts, it would have been unreasonable for anyone to have relied on the reports to  
 25 accurately reflect GVEC's financial state." Dkt. # 155. At 11.

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1     **3.     THE DECISION INVOLVES A LEGAL ISSUE OF SUBSTANTIAL**  
 2     **PUBLIC IMPORTANCE.**

3     The Court's decision also involves a legal issue of substantial public  
 4     importance. A frequently litigated issue in auditor negligence cases is whether  
 5     reliance is an element of a professional negligence claim - or, put another way,  
 6     whether a client's failure to rely upon the accountant's audit report (as when, for  
 7     example, the client had full knowledge of the information allegedly omitted from the  
 8     audited financial statements) constitutes a lack of causation sufficient to negate a  
 9     professional negligence action. As of the date of this request, *Smolen* has been cited  
 10    over 220 times in cases and treatises, and many of those citations relate to the role of  
 11    reliance in relation to the causation element in audit negligence cases. As the Court's  
 12    decision here notes, "numerous circuits and federal district courts have similarly held  
 13    that "innocent reliance is necessary to establish causation in fact" for a professional  
 14    negligence claim based on an auditor's negligent preparation of an audit. Dkt. #155,  
 15    at 5. The Court's clarification of *Smolen* makes clear that California courts follow the  
 16    majority view requiring proof of causation through reliance, as exemplified by the  
 17    holdings in *In re NM Holdings*, 622 F.3d at 620 and *Ernst & Young*, 967 F.2d at 170.  
 18    The Court's clarification of this important rule of law is a matter of substantial public  
 19    importance.

20    **4.     CONCLUSION.**

21    For the foregoing reasons, Stonefield respectfully requests that the Court  
 22    publish its July 30, 2013 decision.

23    DATED: August 26, 2013

GARRETT & TULLY, P.C.

25                                    /S/ Efren A. Compeán

26                                    EFREN A. COMPEÁN  
 27                                    Attorneys for Defendant Stonefield  
 28                                    Josephson, Inc., CPAs

**CERTIFICATE OF SERVICE**

I hereby certify that on August 26, 2013, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List, and I hereby certify that I have mailed the foregoing document or paper via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on August 26, 2013.

/S/ Becky Peña

BECKY PEÑA

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